

# Case Study

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## Defining a Trade Capacity Building Program for USAID in the Republic of Eldorado

### OBJECTIVES FOR THE EXERCISE

1.1 At the FTAA Ministerial Conference held in Nova Santa Maria, Eldorado in March 2002, the U.S. delegation (which included the USAID Assistant Administrator for Latin America and the Caribbean and which was led by the U.S. Trade Representative) held a special meeting with the country's Prime Minister, Ricardo Mojica. At the meeting, the U.S. delegation made a commitment to help Eldorado address some of its priority trade-related capacity building needs. On returning to Washington, the USAID Assistant Administrator for Latin America and the Caribbean (LAC) announced a new program budget of \$1.5 million as part of its Latin America Regional Program for trade capacity-building activities in Eldorado. The \$1.5 million is to be spent over the next 2-3 years. Additional funds may be made available after that time.

1.2 The objective for your team in this exercise is to make a proposal to the Mission Director of USAID and the Government of Eldorado (GOE) on how these funds should be spent. Given previous U.S. involvement in Eldorado, USTR also needs to give full support to the TCB program suggested in your proposal. Before identifying spending priorities, your group should achieve consensus on three priority TCB objectives.

1.3 In preparing your team's proposal, you should select from the list of TCB activities in the GOE's *Trade Development Plan 2002-2005* (see the appendix). This was prepared in late 2001 by the GOE in close collaboration with consultant Tom Pengelly during a mission visit to Eldorado. All of the projects on the list have a maximum duration of 2 years, although, as indicated, some could be considerably shorter.

1.4 Your team's proposal should be based on clear, convincing arguments about the options you have chosen and those you have rejected.



1.5 At the end of the exercise, your team should be ready to make a 3-minute presentation to the rest of the workshop participants.

## **2. BACKGROUND**

### **2.1 General**

2.1.1 The fictional country of Eldorado is one of the smaller economies in Latin America. It has a population of approximately 4 million people. Eldorado is classified as a lower middle income country, according to the World Bank, but is not an LDC. In 2000, per capita income was about \$2,000. Latest UN figures indicate that about 20 percent of the population lives in poverty.

2.1.2 Eldorado has an overcrowded seaport at Nova Santa Maria with aging cargo-handling equipment. It also has a small international airport.

2.1.3 Eldorado is a member of the WTO, having joined at the end of the Uruguay Round, and a member of a regional free trade agreement among the Central American countries. Along with the other Central American countries, it is preparing to negotiate a free trade agreement with the United States. It is involved in external negotiations in the WTO Doha Development Agenda and the Free Trade Area of the Americas, as well as a number of bilateral trade negotiations (e.g., with Chile and Japan). Because of financial and other resource constraints, the country does not maintain a mission in Geneva and often struggles to send a full delegation to negotiations. As a result, Eldorado is something of a spectator in its external trade relations.

2.1.4 Prime Minister Ricardo Mojica took office on August 16, 2000, pledging to maintain the macroeconomic stability that has helped Eldorado achieve economic growth in the past. But public dissatisfaction is growing. The government has been forced to cut back on program spending because of high world oil prices and election year spending in the waning months of the previous administration. These caused a drain on foreign exchange reserves and left a large fiscal deficit. In early November 2000, the Mojica government proposed a series of tax measures to close the government's fiscal deficit and to fund new government programs.

2.1.5 Although Eldorado is heavily indebted, it does not receive assistance under the World Bank's HIPC initiative, which focuses on LDCs. In 2000, the GOE agreed to an Interim Poverty Reduction Strategy Paper with the World Bank and the IMF and it is recognized as having made significant commitments to tackling poverty. The focus of the poverty reduction strategy is the GOE's plans for reform and expansion in the health and education sectors.

### **2.2 Economy**

2.2.1 Reduced demand for Eldorado's exports, especially in the United States, combined with the government's new tax measures, halted growth entirely in the first half of 2001. The terrorist attacks in the United States in September 2001 resulted in a sharp decline in hotel reservations for Eldorado's small

but burgeoning ecotourism industry. Thus, despite signs that economic activity has begun to pick up, growth for 2002 is likely to be minimal. Inflation, which began to edge up toward the end of 2000, moderated in 2001, and will likely approach 10 percent for 2002.

2.2.2 Agriculture (primarily bananas, coffee, fruit juice, beef and seafood) accounts for 25 percent of GDP and employs 40 percent of the labor force. Manufacturing (mainly textiles and clothing products) accounts for about 25 percent of GDP and 15 percent of employment. Service industries account for about 50 percent of GDP and 45 percent of employment. Development of the tourism industry remains difficult because of the rugged coastline, poor state of infrastructure, lack of beach access, and the lack of a modern international airport with good flight connections to North American and European destinations.

2.2.3 U.S. companies have long complained about illegal copying of computer software, films, and music in Eldorado. Piracy rates for some products are claimed to be as high as 65 percent. As a result of these concerns, USTR received a petition from the International Intellectual Property Alliance (IIPA) in 2001 to place Eldorado on the Special 301 watchlist for weak IPR protection. The IIPA cited poor IPR protection, well below the standards required by the TRIPS Agreement. A particular problem appears to be that the GOE Customs service is very ineffective at intercepting and impounding counterfeit goods being brought into the country. A decision has not yet been taken by USTR, but the issue was discussed during meetings between officials from the USG and the GOE in the margins of the FTAA Ministerial meeting.

### Key Economic Indicators (US\$)

	1999	2000	2001
Nominal GDP (billion)	8.0	8.2	8.1
Per Capita GDP (US\$)	1,876	1,994	2006
Unemployment Rate (%)	13.8	13.9	14.0
Consumer Price Inflation	5.10	9.02	8.00
Total Exports FOB (billion)	2.21	2.73	2.18
Total Imports CIF (billion)	4.04	4.48	5.00
Trade Balance (billion)	-2.83	-3.75	-2.82
External Public Debt (billion)	2.66	2.68	2.69
Fiscal Deficit/GDP (pct)	0.8	0.1	N/A
Current Account	2.5	5.2	N/A
Deficit/GDP (pct)			
Aid from Foreign Donors (millions)	401.4	402.6	418.8

2.2.4 Prime Minister Mojica made clear his intention that the benefits of economic development should be shared more broadly through increased government attention to education, housing, agriculture, and health. His plans for new initiatives in these areas have been hampered by internal and external economic difficulties. Currently, there are programs for primary education, agricultural reform, and wastewater disposal for tourist centers.

## **2.3 External Sector Performance**

2.3.1 Eldorado's total exports were worth around \$2.2 billion in 2001. The main exports are bananas, fruits and fruit juices, coffee, textiles, and seafood. Imports are mostly manufactured goods. Most exports go to the EU (30 percent) and North America (40 percent), with the remainder being sold in the region (30 percent). It can therefore be observed that the exports are fairly heavily concentrated in a few key sectors and overseas markets.

2.3.2 So far this year, Eldorado's foodstuffs exports have slumped 10 percent because its frozen fruit juice concentrate exports to the United States are facing anti-dumping duties. In addition, its coffee exports are suffering because of depressed world prices, which are hitting small producers hard; and its seafood exports to the EU had compliance problems with SPS standards, costing the country about \$150m in unrealized exports last year. This downturn in Eldorado's key export industries is causing considerable political concern because of fears of rising unemployment and intense pressure from the private sector for the government to take action.

2.3.3 Some believe that the textiles and clothing export sector could be expanded, particularly by increasing exports to the United States and EU, where Eldorado is only using about 40 percent of its total quotas. Eldorado, however, is likely to face growing competition from other low-cost producers such as China. The Chamber of Commerce is campaigning against the high tariff peaks on intermediary inputs for the textiles sector, such as machinery and fabric dyes. The Chamber claims these are pushing up prices of Eldorado's textile exports abroad and making them uncompetitive. Over the longer term, the services sector has been identified as an important export prospect because of the country's proximity to North America and relatively high levels of education. But limited fluency in English compared to other developing countries in the region (e.g., the Anglophone Caribbean) could be a constraint.

2.3.4 Despite Eldorado's lack of accessible beaches, studies by U.S. tour operators indicate significant future growth in ecotourism and adventure tour operations. Alternatively, waterfront development of more traditional beach resorts would require considerable immediate investment for uncertain future returns given the related infrastructure requirements (airport, hotels, etc.)

2.3.5 Constraints on competitiveness and trade expansion in Eldorado include problems with access to certain key export markets, weak port infrastructure, inefficient customs administration, and uneven compliance with international standards in such areas as protection for intellectual property rights holders and investors. Other problems for the exporting industries are lack of trade finance, persistent anti-export bias in the tariff and trade taxes regime, and a cumbersome regulatory environment (for example, duty drawback for exporting firms can take months to process). Eldorado has only a rudimentary domestic competition policy regime and a skeleton competition authority with few trained professional staff.

2.3.6 Bringing goods through Eldorado Customs can often be slow and arduous. The Customs Department's interpretation of exonerated materials being brought into the country often provokes

complaints by businesspersons. The use of “negotiated fee” practices to gain faster customs clearance continues to put foreign firms at a competitive disadvantage in the domestic market.

2.3.7 Eldorado requires a consular invoice and “legalization” of documents, which must be performed by an Eldorado Consulate in the country of export. Fees for this service vary by consulate but can be substantial. Some importers now pay the consular invoice fee at the port directly to Customs. Moreover, importers are frequently required to obtain licenses from the GOE Customs Service.

2.3.8 Foreign direct investment is impeded by inefficiencies in the system. Although passed in November 1995, legislation designed to improve the investment climate does not contain procedures for settling disputes arising from GOE actions. The seizures of foreign investors' property by past governments (claims for which are still unresolved), refusal to honor customs exoneration commitments, and the government's slowness in resolving claims for payment reduce the attractiveness of the investment climate, passage of the 1995 legislation notwithstanding. Foreign investment must receive approval from the Foreign Investment Directorate of the Central Bank to qualify for repatriation of profits. The new law provides for repatriation of 100 percent of profits and capital and nearly automatic approval of investments. Foreign employees may not exceed 20 percent of a firm's work force.

2.3.9 GOE expropriation standards (e.g., in the "public interest") do not appear to be consistent with international law standards. Several investors have outstanding disputes concerning expropriated property. The government maintains that it wishes to resolve these issues, but progress has been slow.

2.3.10 The GOE has taken steps to improve protection of intellectual property rights, but piracy is a serious problem. Eldorado belongs to the WTO, and is a signatory to the Paris Convention, Berne Convention, Madrid Agreement, and the Rome Convention. Copyrights are difficult to enforce against a determined intellectual property thief. New copyright legislation passed in 2000 does not appear to be wholly in compliance with Eldorado's obligations under the WTO Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS). The Mojica government, however, has pledged to bring IPR protection up to TRIPS standards.

## **2.4 Trade policy and Trade Sector Institutions**

2.4.1 If the GOE and other Central American countries are able to conclude a free trade agreement with the United States, tariff rates on imports will be further reduced. Most tariffs now range from 3 to 20 percent. Virtually all tariffs are bound in the WTO at 40 percent. GOE ministers are concerned that further cuts in tariffs and trade taxes will significantly reduce government revenues, thereby making it difficult to fund the planned major extension of secondary and tertiary education, as well as new primary health care centers in poor areas. The IMF has pointed to the need to broaden the national tax base and has offered to provide special technical assistance on tax system reform (the introduction of a VAT system). While this may be good practice in fiscal policy, introducing a VAT system in Eldorado is likely to be politically unpopular.

2.4.2 Administration and implementation of current free trade agreements and preferential arrangements, together with negotiation of new agreements such as the FTAA, create a significant burden for the institutions tasked with trade-related responsibilities in the GOE. Most of the responsibility falls to the Ministry of Trade and the National Customs Authority. Ministries of Industrial Development, Agriculture, Finance, the Central Bank, together with the President's Special Advisory Council on Economic Affairs, also play key roles. Power struggles between the leadership of the trade ministry and the customs authority often result in fragmented or ineffective applications of trade policy. Policy coordination and communication among government bodies with trade-related responsibilities is also insufficient.

2.4.3 Even without a formal consultative mechanism, the public and private sector enjoy a fair degree of cooperation in developing and promoting trade initiatives. Private sector institutions that play a role include business and professional organizations, universities, labor organizations, and certain NGOs. Depending on the political climate, some private sector organizations have better access to government decision-makers than others. A nucleus of academic trade experts from the region is based at the University of Santa Maria in Nova Santa Maria, but lacks resources and a sound institutional setting from which to operate. As a result, training, academic teaching, and research on trade-related issues in Eldorado is rare.

2.4.4 When a new political regime takes power, new officials appointed by the new Prime Minister replace most of the senior officials in government departments. Outgoing officials usually find work in business or other private sector organizations. Maintaining an experienced and well-trained staff in the key trade sector institutions is therefore difficult. Indeed, many of the staff now in senior positions in the Ministry of Trade and other agencies have been in their posts for less than two years and know little about external trade negotiations and trade agreements to which Eldorado is party. As a result, the GOE faces considerable challenges in meeting its obligations under external trade agreements and in participating effectively in ongoing trade negotiations.

### **3. CHECKLIST OF KEY ISSUES**

3.1 In preparing your proposal, pay attention to the following issues, all of which were highlighted during meetings between USAID, USTR, and GOE officials in the margins of the FTAA Ministerial meeting.

- Maximizing local stakeholder ownership of USAID's TCB program.
- Maximizing opportunities for coordination with other donor agencies.
- Harmonizing Eldorado's TCB objectives with wider U.S. Government objectives for the region, including U.S. commercial objectives.
- Building local human resources and institutional capacity to understand trade issues and support policymaking.
- Addressing current key issues and problems in the trade sector, including those facing the private sector as well as the GOE.

- Staying within the overall USAID budget allocation and ensuring good value for money—“getting the biggest bang for the buck.”
- Addressing the GOE’s priority short-term needs, but also considering longer-term requirements for TCB in Eldorado and the sustainability of USAID’s interventions.

## Appendix. Eldorado's Trade Development Plan 2002-2005

Project Title/Description	Cost (US \$)	Estimated Start
<b>1. RESIDENT INTERNATIONAL TRADE ADVISERS</b>		
To strengthen the capacity of the Ministry of Trade, the GOE has asked for 1 to 3 International Trade Advisors. Competent and experienced in key areas of the trade negotiations (e.g. agriculture, services), the advisors will assist the Ministry of Trade in preparing for negotiations, consulting/briefing stakeholders, and participating in the negotiations themselves. Although advisors could do some sector- specific analytical work in their areas of competence, they will most likely be assisting the Ministry in by defining and prioritizing research needs, commissioning studies from consultants and research institutions, and ensuring that the findings are translated into GOE negotiating positions. The Government is keen that a consultant from the region be appointed to at least one of the posts, and preferably two of the three. Costs per advisor include elements for return flights, local travel, accommodation, secretarial support.	\$300,000 per International Adviser  \$150,000 per Regional Adviser	Feb. 2003
<b>2. STUDIES FOR EXTERNAL TRADE NEGOTIATIONS</b>		
The Government would like to have some detailed policy analysis studies undertaken to help prepare its negotiating positions for the WTO and FTAA. The Government has prepared a list of 12 areas where studies would be useful.	\$100k per study (all international consultants)	Jan. 2003
The studies are on Agriculture, Services, and Market Access for Goods, Trade Facilitation, TRIPS, Trade & Investment, Trade & Competition, Government Procurement, Trade & Environment, WTO rules, E-commerce. It is also especially interested in the work program on Small Economies.	\$75k per study (International and local consultants)	
The EC has agreed to fund three studies. But the studies have not yet been chosen, nor consultants appointed. IADB has also indicated that it would be willing to fund up to three studies under its FTAA facility. A concern of the Government is coordination across the different trade negotiations, particularly with different donors involved.	\$50k per study (all local consultants)	
<b>3. COFFEE EXPORT MARKETING PROJECT</b>		
The project includes components for export market analysis studies, TA for product strategy and packaging, and international marketing campaigns using an advertising consultancy company.	\$750,000	Feb. 2003
The Government has given this project high priority because it is under pressure to help coffee producers and preserve thousands of jobs for the many low-paid workers in the sector. This has come about as a result of the slump in world coffee prices.		



Project Title/Description	Cost (US \$)	Estimated Start
<b>4. WTO TRAINING AND WORKSHOPS</b>		
This project would consist of a number of in-country training workshops on WTO Agreements and new WTO negotiations. A study tour for 10 persons from the GOE in Geneva is also required.	\$150,000 (WTO)	Sept. 2003
There are two options for delivering this project. The first is to use the WTO Secretariat, plus staff from UNCTAD and ITC. The agencies are willing to provide staff free of charge, although USAID will pay all expenses. But WTO staff are not available until March 2003. The second option is to use consultants. This would be more expensive because of fees, but could be delivered more quickly.	\$300,000 (Consultants)	Jan. 2003
<b>5. SUPPORT FOR PARTICIPATION IN TRADE NEGOTIATIONS</b>		
This project would provide financial support for the Ministry of Trade to improve its participation in international trade negotiations. The project budget provides for subscriptions to key databases and journals, laptop computers for negotiators, fax and communications equipment, overseas travel, subsistence, etc. The optional consultancy support would provide for a panel of sector experts to be on-call for the GOE during the negotiations to give briefings, advise on specific issues, and accompany negotiating teams as required.	\$100,000  + Optional consultancy support @ \$250,000	Feb. 2003
<b>6. TRIPS IMPLEMENTATION</b>		
The project would include components on drafting new TRIPS-compliant legislation; automating the new IP Office, training judges and enforcement agencies, and consultancy support. WIPO is already providing some training and advice on legislative reform. It is willing to provide up to \$0.5m of the total project cost of \$0.8m over the next two years. USTR is very keen to have USAID support this project.	\$800,000	Jan. 2003
<b>7. GOE MISSION IN GENEVA</b>		
The project covers all the costs for the establishment of a 4-person permanent mission in Geneva. The GOE will pay all staff salaries, but the project covers the accommodation and subsistence allowances for a two-year period. The GOE has completed the necessary formalities with the Swiss authorities and is keen that mission staff be trained on WTO agreements and new negotiations before taking up the post in Geneva. The Prime Minister has indicated that he attaches high personal priority to this project, and that the GOE will make every effort to ensure that financing for the Mission is made available after the project ends.	\$750,000	Feb. 2003

Project Title/Description	Cost (US \$)	Estimated Start
<p><b>8. TRADE POLICY AND LAW CENTER</b></p> <p>This project involves establishment and start-up costs for a regional center for trade policy/law research, training, and consultancy. The CTPL in Ottawa would manage the project and provide technical support. The center would be based at the University of Santa Maria. The aim of the center would be to provide an advisory and teaching resource for governments and business in the region on trade policy issues. For example, the center would assemble a roster of local consultants to undertake trade policy studies on behalf of governments to inform negotiating positions, and offer training courses on the WTO and FTAA for regional businesses.</p> <p>CIDA has also expressed an interest in this project and is ready to look at co-financing with other donors, up to a maximum of \$250,000 of the total project cost of \$0.5m. The Canadian CTPL in Ottawa has assisted with the preparation of the project proposal.</p>	\$500,000	June 2003
<p><b>9. EXPORT DEVELOPMENT &amp; DIVERSIFICATION PROGRAM (PHASE I)</b></p> <p>The EDDP will aim to provide a comprehensive package of trade-related capacity building and policy reform measures in order to expand/diversify Eldorado's trade base and boost its competitiveness. The EDDP will finance development of an export processing zone, targeted to clothing and textile production; a grant/loan facility for new export products; training for textile industry workers to increase productivity rates; and TA for tariff reforms to lower costs of essential inputs to export industries.</p> <p>Phase I is a feasibility and design study for Phase II of the program. Phase II is estimated to cost \$30m over 3 years. The EC, IADB, and the World Bank have pledged to support the EDDP, but they have all stated that they lack funds to complete Phase I for another 12 months. Therefore, GOE has asked USAID to consider financing Phase I and sharing the study with all the other donors. USAID would also be asked to consult the other potential Phase II donors on the Terms of Reference for the study and the choice of consultants.</p>	\$350,000	Feb. 2003
<p><b>10. COMPETITION POLICY INSTITUTIONAL STRENGTHENING PROJECT</b></p> <p>This project provides long-term technical assistance and training for the modernisation of the legal and institutional framework for the national competition policy regime. Under this two year project, competition legislation would be reviewed and updated by international experts and assistance and training would be provided to local staff at the Eldorado Board of Competition to enable them to conduct investigations into anti-competitive restrictive business practice and take appropriate action. Training in aspects of competition policy and law would also be provided to judges and enforcement agencies.</p> <p>The project would also focus on modernizing regulatory frameworks in key sectors of the economy (telecommunications, energy, financial services), many of which have been recently privatized (or will be), to help ensure open, contestable markets for consumers which will contribute to achieving faster economic growth.</p>	\$600,000	Sept. 2003

Project Title/Description	Cost (US \$)	Estimated Start
<b>11. FOOD STANDARDS AGENCY PROJECT</b>		
This project provides long-term technical assistance, training, and finance for the establishment of a national SPS enquiry point and a specialist unit dealing with seafood export standards in GOE's Food Standards Agency. The <i>seafood exports unit</i> will provide specialist advisory services to the country's seafood exporters in complying with export market standards and it will act as the competent authority for certifying exports and performing other statutory functions under the EU's standards regime.	\$450,000	June 2003
<b>12. TAX SYSTEM REFORM PROGRAMME (PHASE I)</b>		
This project aims to help GOE introduce tax policy reform measures in order to broaden the national tax base in the light of the forecast reduced revenues from customs duties, as a result of recent and planned trade liberalization.	\$500,000	July 2003
Phase I is the provision of technical experts to advise GOE and complete the initial design of proposals for tax reform, including the gradual introduction of a VAT system. It is estimated to cost \$500,000 over 1 year. Phase II would follow on, providing comprehensive technical support for implementation of the preferred tax reform option nationwide. The cost and timetable of Phase II is not known at this stage. The IMF has offered to provide 50% of co-financing for Phase I.		
<b>13. WORLD BANK PORT DEVELOPMENT PROJECT (CUSTOMS COMPONENT)</b>		
This project will provide short-term technical assistance, computerization, and training for the GOE Customs Agency. USAID has been invited to fund this component, given its emphasis on this sector, as part of a larger Port Development Project being planned by the World Bank. The project will provide for full implementation of the WTO Customs Valuation Agreement. Provisional estimates suggest that it could also generate increased revenue collection of about 10-15 percent. USTR is very keen to have USAID support this project.	\$600,000	April 2003